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In the Supreme Court of the United States

OCTOBER TERM, 1951

No. 53

LOUIS RUBINO AND CATHERINE RUBINO, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 26-41) are unreported. The *per curiam* opinion of the Court of Appeals (R. 99-100) is reported at 186 F. 2d 304.

JURISDICTION

The judgments of the Court of Appeals were entered on January 2, 1951. (R. 100-101.) The petition for rehearing was denied on February 8,

1951. (R. 102.) The petition for a writ of certiorari was filed on May 7, 1951. The jurisdiction of this Court is invoked under 28 U.S.C., Sec. 1254.

QUESTION PRESENTED

Whether the courts below properly sustained the Commissioner's determination that the property involved was held by taxpayer [1] primarily for sale to customers in the ordinary course of business so that the profits from the sale of such property are taxable as ordinary income and not as capital gains under Section 117(j) of the Internal Revenue Code.

STATUTE AND REGULATIONS INVOLVED

These are set out in the Appendix, *infra*.

STATEMENT

The Tax Court found the following facts (R. 28-32):

The taxpayers are husband and wife residing at Stockton, California. They filed separate tax returns for the years involved on the community property basis. During these years taxpayer owned and operated the Alpine Mill & Lumber Company and was also engaged in the business of ranching and building homes for sale. (R. 28.)

In order to obtain materials needed for the building of houses, taxpayer filed with the Office of Production Management in February, 1942, an application for priorities for materials to be used in the construction of 49 dwelling houses and

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[1] At the request of counsel for the taxpayers, only the record of Louis Rubino has been printed (R. 94) so that, unless otherwise indicated, record references herein will be to his case and he will be called the "taxpayer,"

another application for priorities for materials to be used in the construction of 13 dwelling houses. Both applications were approved on April 7, 1942. In the applications taxpayer stated that the proposed total monthly rental to be charged per dwelling unit was $50. (R. 28-29.)

During the war years the National Housing Agency issued certain general orders, one of which included "III. National Housing Agency General Orders, Part 702, Title 24, Code of Federal Regulations." (R. 29.) Section 5 of that order provided as follows (R. 29-30).

> Section 5. Disposition of Private War Housing
>
> .01 Private war housing begun on or after February 10, 1943, shall be held for rental only to eligible war workers for the duration of the national emergency declared by the President on September 8, 1939, and, except for involuntary transfers, shall be disposed of only as follows:
>
> a. An occupant, after two months' occupancy, may purchase the private war housing unit occupied by him subject to NHA General Order No. 60-3.
>
> b. A person who will not himself occupy such housing may purchase or otherwise acquire such housing at any time, in accordance with NHA General Order No. 60-3, provided the occupancy and disposition limitations applicable to such housing prior to such purchase or acquisition shall continue to be applicable to such housing after such purchase or acquisition, or
>
> c. At any time subsequent to 60 days after completion of any such housing, the owner of such housing may petition the National Housing Agency, in accordance with NHA

General Order No. 60-3, to permit such housing to be disposed of otherwise than as provided above in this subsection 5.01.

The fair average useful life of the dwellings rented by taxpayer in 1943 was 30 years. The taxpayers in their 1943 income tax returns deducted depreciation amounting to $2,141.15 in total on 30 of such dwellings which had been rented during 1943 and which were being rented at the end of that year. The deduction was not changed or adjusted by the Commissioner on audit of the returns. The taxpayers did not deduct in their income tax returns for 1942 and 1943 any amount for the depreciation of 10 dwellings which were sold during 1943 and which had been rented on an oral lease month-to-month basis. All of taxpayer's houses which he rented were rented on that basis. In addition, due to the shortage of housing, most of the homes which taxpayer rented were rented prior to completion. The depreciation allowable on the 10 dwellings amounts in total to $110.83 for the year 1942 and to $735.75 for the year 1943. (R. 30.)

During the taxable year 1943 taxpayer sold 33 dwellings. On their 1943 returns the taxpayers showed the reported gains on 23 of such dwellings as short-term capital gains and on 10 of the dwellings as long-term capital gains. Of these 10 houses, three were constructed or completed in 1942, three in February, 1943, and four in March, 1943. The gross sales price of the 10 dwellings and the lots on which they were located was $53,465 and the realized gain by the taxpayers, after adjusting for the allowable depreciation of $110.83 and $735.75 for the taxable years 1942 and 1943, re-

spectively, as set forth in the above paragraph, was $17,164.11. (R. 30-31.)

In 1944 taxpayer sold 27 houses, one of which had been constructed in 1941, one in 1942, 15 in 1943, and 10 in 1944. During 1945 he sold four homes that were constructed in 1943. (R. 31.)

The sales and rentals of the houses owned by taxpayer in 1943 were handled by real estate brokers. Taxpayer previously had constructed and held homes for sale in 1940 and 1941. (R. 31.)

For the year 1943 taxpayer's receipts from the rental of real estate were $15,108.28, and after deduction of depreciation of $2,141.15 his rental income was $12,967.13 before deductions for interest on mortgages, taxes, maintenance, overhead, real estate agents' commissions, etc. His profit on real estate sold during the same year was $35,458.25 after deduction of both direct and indirect costs. (R. 31.)

In the "Explanation of Adjustments" concerning the property which taxpayer sold in 1943 the receipts from which taxpayer had treated as taxable as capital gains, the Commissioner stated as follows (R. 31-32):

> During the taxable year 1943 you sold thirty-three houses of which three were constructed by you during the last six months of 1942 and the remaining thirty during 1943. Since these transactions were frequent and continuous, it is considered that these houses are properly held for sale to customers in the ordinary course of your business. Accordingly, the profit realized on such sales is taxable as ordinary income.

On these facts, the Tax Court expressly found that the dwelling units involved, together with the lots, were held by taxpayer primarily for sale to customers in the ordinary course of his business. (R. 32.)

The Tax Court accordingly upheld the Commissioner's determination. (R. 34-39.) The Court of Appeals affirmed. (R. 100.)

ARGUMENT

The question presented is whether the gains from the sales here involved are taxable as ordinary income, as determined by the Commissioner and held by the courts below; or whether such gains should be treated as capital gains under Section 117(j) of the Internal Revenue Code (Appendix, *infra*), as claimed by the taxpayer.

Section 117(a) of the Internal Revenue Code (Appendix, *infra*) excludes, among other things, from the definition of "capital assets" property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, depreciable property used in the trade or business, and real property used in the trade or business of the taxpayer.

In 1942 Section 117(j) was added to the Code. This provides for special treatment where gains exceed losses from the sale or exchange of certain property used in the trade or business. Such gains are treated as capital gains. This is a relief provision for the benefit of such taxpayers as come within it. See *Hazard* v. *Commissioner*, 7 T. C. 372, 376[2] (Acquiescence, 1946-2 Cum. Bull. 3).

[2] The Tax Court said (7 T. C. at page 376):
Section 151 (b) of the 1942 Act added the new subsection

However, Section 117(j) expressly excludes property held by the taxpayer primarily for the sale to customers in the ordinary course of his trade or business, and the gains from the sale of property so held are taxable as ordinary income.

Accordingly, if the property here involved was held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, then the profits in question cannot be treated as capital gains under either Section 117(a) or (j), and must therefore be treated as ordinary income.

The Commissioner made the following determination in the instant case (R. 19, 31-32):

> During the taxable year 1943 you sold thirty-three houses of which three were constructed by you during the last six months of 1942 and the remaining thirty during 1943. Since these transactions were frequent and continuous, it is considered that these houses are properly held for sale to customers in the ordinary course of your business. Accordingly, the profit realized on such sales is taxable as ordinary income.

The Tax Court upheld that determination (R. 35) and specifically found (R. 32) as an ultimate fact that the property was held by taxpayer pri-

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(j), covering, as its title indicates, "Gains and Losses From Involuntary Conversions and From the Sale or Exchange of Certain Property Used in the Trade or Business." This section provides for special treatment where gains exceed losses from involuntary conversions and from the sale of certain property used in a trade or business. Such gains are treated as capital gains. This is a relief provision for the benefit of such taxpayers as come within its provisions. Losses in excess of gains in respect to such property are still treated as ordinary losses allowable in full.

marily for sale to customers in the ordinary course of his business. The Court of Appeals in affirming said (R. 100):

> The issue is essentially one of fact. We see no clear error in the Court's finding, and its judgment is accordingly affirmed.

The Tax Court's finding is clearly correct, and there is ample evidence to sustain it. The sales were not casual but frequent and continuous, the profits realized were substantial, and in his 1942 income tax return taxpayer stated (R. 35) he was building homes for sale. Taxpayer's effort to prove he was engaged primarily in renting the property did not succeed in the lower courts.

Taxpayer urges (Pet. 6-8) there is a conflict in principle with *Delsing* v. *United States,* 186 F. 2d 59 (C. A. 5th). That case is plainly distinguishable. The court there merely concluded that on the particular facts of that case, the finding of the District Court was clearly erroneous. The instant case, on its facts, more closely resembles *King* v. *Commissioner,* decided May 22, 1951, where the Fifth Circuit distinguished the *Delsing* case and upheld the Tax Court's finding. Cf. also *White* v. *Commissioner,* 172 F. 2d 629 (C. A. 5th); *Snell* v. *Commissioner,* 97 F. 2d 891 (C. A. 5th); *Greene* v. *Commissioner,* 141 F. 2d 645 (C. A. 5th), certiorari denied, 323 U. S. 717; *Ehrman* v. *Commissioner,* 120 F. 2d 607 (C. A. 9th), certiorari denied, 314 U. S. 668. And see *Board of Governors* v. *Agnew,* 329 U. S. 441, 446.

Taxpayer says (Br. 14-15) that the Commissioner stipulated away the case in agreeing (R. 75) that depreciation was allowable on the dwellings

We submit that this contention is without merit, and that *Hackfeld & Co.* v. *United States,* 197 U. S. 442, cited by taxpayer, does not support his position. The allowance of depreciation deductions under Section 23(l) is entirely consistent with the conclusion that the property was held primarily for sale. Moreover, nothing in Section 29.23(l)-2 of Treasury Regulations 111, cited by taxpayer, is to the contrary. True, depreciation is allowed only in respect of property used in the trade or business, or in respect of property held for the production of income. But a taxpayer may have more than one business (*Fackler* v. *Commissioner,* 133 F. 2d 509 (C. A. 6th); *Harvey* v. *Commissioner,* 171 F. 2d 952 (C. A. 9th)), and where as here the property was rented, depreciation is allowable even though the renting is essentially temporary (R. 37) and the property is held primarily for sale to customers in the ordinary course of business. Depreciation is generally allowed in respect of rented buildings and this is so without regard to whether they are held primarily for sale. *A. L. Carter Co.* v. *Commissioner,* 143 F. 2d 296 (C. A. 5th); *Black* v. *Commissioner,* 45 B.T.A. 204; Bulletin F, Bureau of Internal Revenue (Revised January, 1942), p. 85.

Taxpayer says (Br. 15-17) that the Regulations (Treasury Regulations 111, Section 29.117-7 (Appendix, *infra*)) are wrong in providing that the time of sale is the critical time for determining whether the property was held primarily for sale. We disagree (cf. *Heiner* v. *Tindle,* 276 U. S. 582; *Marks & Co.* v. *Commissioner,* 12 T. C. 1196, Acquiescence, 1949-2 Cum. Bull. 3), but in any event the question is academic here for the record shows and

the Tax Court found (R. 36)[3] that the homes in question were built by taxpayer for sale and he continued to hold them for that purpose. Clearly that purpose dominated the entire course of dealings, as the Tax Court found.

Taxpayer says (Pet. 8-10; Br. 17-22) that there is an important legal question "whether the exclusionary clauses (A) and (B) of Section 117(j)(1) are limitations upon depreciable property, as well as upon real property," and he takes the view that they do not apply to depreciable property. But that view is contrary to the plain language of the statute (Appendix, *infra*), the provisions of the Regulations (Treasury Regulations 111, Section 29.117-7 (Appendix, *infra*)), and the interpretation placed upon the statute by court decisions (*Hazard* v. *Commissioner, supra; Farry* v. *Commissioner,* 13 T. C. 8 (Acquiescence 1950-1 Cum. Bull. 2); *Albright* v. *Commissioner,* 173 F. 2d 339 (C. A. 8th); *United States* v. *Bennett,* 186 F. 2d 407 (C. A. 5th)). Nor is taxpayer's contention supported by the committee reports to which he refers. See particularly S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 119-120 (1942-2 Cum. Bull. 504, 594).

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[3] The Tax Court said (R. 35-36):

> Of course the fact that petitioner was building homes for sale is not controlling if it can be shown by convincing evidence that such homes were converted to rental properties and that they were held primarily for that purpose at the time of sale See *Carl Marks, Inc.*, 12 T. C. 1196. We think, however, that the record affirmatively shows that not only were the homes in question built by petitioner for sale, but that he continued to hold them for that purpose. In the year involved he sold 33 of the 62 houses constructed during 1942 and 1943. He sold 27 additional homes in 1944 and 4 more in 1945. His profits from sales of homes during 1943 far exceeded his net income from rentals.

Moreover, it was apparently one of the purposes of the 1942 amendments to avoid complicated allocations between land and depreciable improvements such as were necessary under Section 117 of the Revenue Act of 1938, c. 289, 52 Stat. 447 (see I. T. 3217, 1938-2 Cum. Bull. 94; I. T. 3246, 1939-1 Cum. Bull. (Part 1) 137), and taxpayer's contention would necessitate such an allocation.

CONCLUSION

The decision is correct; there is no conflict of decisions; and the petition for certiorari should be denied.

Respectfully submitted,

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JUNE, 1951.

APPENDIX

Internal Revenue Code:

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) [as amended by Sec. 151(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798.] *Capital Assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l), or real property used in the trade or business of the taxpayer.

* * * * *

(j) [as added by Sec. 151(b) of the Revenue Act of 1942, c. 619, 56 Stat. 798, and amended by Sec. 127 of the Revenue Act of 1943, c. 63, 58 Stat. 21.] *Gains and Losses from Involuntary Conversion and From the Sale or Exchange of Certain Property Used in the Trade or Business.*—

(1) *Definition of Property Used in the Trade or Business.*—For the purposes of this subsection, the term "property used in the trade or business" means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l), held for more than 6 months, and real property used in the trade

or business, held for more than 6 months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. Such term also includes timber with respect to which subsection (k)(1) or (2) is applicable.

(2) *General Rule.*—If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. For the purposes of this paragraph:

(A) In determining under this paragraph whether gains exceed losses, the gains and losses described therein shall be included only if and to the extent taken into account in computing net income, except that subsections (b) and (d) shall not apply.

(B) Losses upon the destruction, in whole or in part, theft or seizure, or

requisition or condemnation of property used in the trade or business or capital assets held for more than 6 months shall be considered losses from a compulsory or involuntary conversion.

* * * * *

(26 U.S.C. 1946 ed., Sec. 117.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.117-7 [as amended by T. D. 5394, 1944 Cum. Bull. 274,276.] *Gains and Losses from Involuntary Conversions and from the Sale or Exchange of Certain Property Used in the Trade or Business.*—Section 117(j) provides that the recognized gains and losses

(a) from the sale, exchange, or involuntary conversion of property used in the trade or business of the taxpayer at the time of the sale, exchange, or involuntary conversion, held for more than six months, which is

(1) of a character subject to the allowance for depreciation provided in section 23 (l), or
(2) real property,

provided that such property is not of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or is not held by the taxpayer primarily for sale to customers in the ordinary course of trade or business, and

* * * * *

shall be treated as gains and losses from the sale or exchange of capital assets held for more than six months if the aggregate of such gains exceeds the aggregate of such losses. If the aggregate of such gains does not exceed the aggregate of such losses, such gains and losses shall not be treated as gains and losses from the sale or exchange of capital assets.

* * * * *

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